Rationales and Challenges for a Digital Service Tax: Focusing on Location-Specific Rent

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Abstract

A discussion, focusing on the present-day OECD, is being carried out with regard to taxation that is compatible with the digitalization of the economy. Despite the efforts of the OECD, each country has been working on the introduction of a digital service tax through unilateral or interim measures. Such a tax has been criticized as an ambush, as not allowing coordination under treaty agreements, and as a system that targets specific companies.

However, Professor Wei Cui has observed in relation to a digital service tax that digital platforms would earn Location-Specific Rents in conditions not unlike those that arise when mining natural resources, and contends that this has a rationale in the user's country's right to tax digital platform corporations.

The present paper explores the rationale behind a digital service tax through Cui's opinion and expert analyses responding to it. The important factors in this discussion include the fact that businesses that run digital platforms with controlling power in the market have a dual nature and indirectly network effects; the fact that marginal costs are currently low and that the revenue of takings has been shown to be very close to profits; and the fact that there is scope for the view that coordination under treaty agreements is not necessary.

Keywords: digital platform, allocation of taxing rights, location-specific rent, location neutrality, two-sided business, indirect network effect, avoiding double taxation.

I. Introduction

As the world becomes ever more digitalized, even tax-related fields have seen changes. These changes have recently been affected by the infectious spread of the novel coronavirus disease. In November 2020, for example, despite a 28% drop in year-on-year corporate tax revenues, as published by Japan's Ministry of Finance,[1] for September of that year, quarterly net profits for Alphabet Inc. (Google), Facebook, and Amazon for July–September 2020 were the highest on record.[2] Expanding digitalization due to the coronavirus crisis has been advantageous for some large IT enterprises.

[1] *Nihon Keizai Shimbun* for Oct. 30, 2020, evening edition, p. 3.
[2] *Nihon Keizai Shimbun* for Nov. 3, 2020, morning edition, p. 5.

The COVID-19 crisis may have brought the matter into sharp relief, but the way in which businesses such as digital platforms are taxed was contentious before then. This was because the current tax rules are incompatible with business models in which economic activity is carried out by businesses in market jurisdictions where they have no physical presence.

Since the October 2015 publication of the final report of the Base Erosion and Profit Shifting (BEPS) Action Plan, the OECD has been addressing taxation issues associated with the digitalization of the economy. This has mainly been publicized in the March 2018 "Tax Challenges Arising from Digitalization—Interim Report 2018"[3] and the June 2019 "Program of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalization of the Economy."[4] The proposed solutions suggested by the OECD have comprised two pillars: "Pillar One" revises rules for distributing taxable income appropriately to market jurisdictions, and "Pillar Two" introduces measures opposing the relocation of profit to low-taxation countries.

From the outset, the intention was to present solutions after achieving consensus from all countries at the end of 2020.[5] However, this plan was postponed to mid-2021 due to challenges such as the new coronavirus disease. Nevertheless, on October 12, 2020, the OECD published its "Reports on the Blueprints of Pillar One and Pillar Two[6]" and its "Report on Economic Impact Assessment."[7] Moreover, it clarified that, in January 2021, a public consultation would be held, for which written comments were requested by December 14, 2020.

Responding to the digitalization of the economy, this project concerns not just the OECD countries and the G20 but also the Inclusive Framework on BEPS, which comprises 137 countries. Many of these countries are developing countries or emerging markets (greater in number than the advanced countries). Although a "consensus solution" requires the consent of these countries, obtaining it will not be simple. For developing countries, it is essential to consider the fact that they will be unable to put a solution into practice if it is not enforceable (the United Nations has received a lot of attention in this regard, especially Draft Article 12B of the United Nations Model Tax Convention).

Despite the efforts of the OECD, each country has been working on unilateral tax measures to introduce such as a digital service tax (DST). In Europe, this includes France, the UK, Austria, the Czech Republic, Hungary, Italy, Latvia, Norway, Poland, Slovakia, Slovenia, Spain, and Turkey. In France, a bill passed through the lower house on June 26, 2019,

[3] OECD (2018), Tax Challenges Arising from Digitalisation – Interim Report 2018: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris.
[4] OECD (2019), Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy, OECD/G20 Inclusive Framework on BEPS, OECD, Paris.
[5] OECD (2020), Statement by the OECD/G20 Inclusive Framework on BEPS on the Two-Pillar Approach to Address the Tax Challenges Arising from the Digitalisation of the Economy – January 2020, OECD/G20 Inclusive Framework on BEPS, OECD, Paris.
[6] OECD (2020), Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint and Report on Pillar Two Blueprint: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris.
[7] OECD (2020), Tax Challenges Arising from Digitalisation – Economic Impact Assessment: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris.

and through the upper house on July 11, was signed by President Macron on July 24, and came into force the following day.[8] A DST also came into force in the UK from April 1, 2020.[9] It will surely no longer be possible to turn a blind eye to giant digital platform corporations when it comes to tax leakage.

France's DST targets companies that operate in online advertising, in data sales aimed at advertising, and as intermediary platforms. It will be paid by companies that earn a global revenue of over 750 million EUR from relevant projects and that earn over 25 million EUR from relevant projects in France. Income from relevant projects are taxed at 3%, and a tax yield of around 2 billion EUR is expected over the next four years. Moreover, online advertising company Criteo may be the only French company targeted for DST, so this has been described as a system designed to take shots at American corporations.[10]

The UK's DST has been applied to groups with global revenue on a consolidated basis from digital services of over 500 million GBP and revenue from digital services in the UK of over 250 billion GBP. The companies it targets are social media platforms, web search engines, and online marketplaces; digital service revenue in the UK arising from these are taxed at 2%.[11]

These DSTs have been criticized for jumping the gun. US Secretary of the Treasury Steven Mnuchin has suggested that if the UK establishes a DST, the US may apply a tax on UK automobile exports to the US. However, the UK has said that it will withdraw its DST by the end of 2020 if a consensus is reached through the OECD framework[12] (other countries have acted similarly, referring to their DSTs as an interim measure). The UK's DST, planned to come into force from April 2020, is to be paid nine months after the accounting period ends, so the earliest accounting period during which taxpayers will be affected by it will begin on April 1, 2021.[13]

Unlike the UK, France's DST has already come into force, but the US has also made threats to apply retaliatory tariffs on France. On July 10, 2019, the US Trade Representative announced that it had begun an investigation based on Article 301 of the Trade Act.[14] However, both countries subsequently reached an agreement.[15] On January 22, 2020, it was reported that the US and France had officially agreed that the French government would shelve levies concerning digital taxation introduced to target major US IT companies by the

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[8] *See* Eli Hadzhieva, Impact of Digitalisation on International Tax Matters, pp. 39-43 (Feb. 2019); Teri Sprackland & Stephanie Soong Johnston, French DST Signed Into Law Despite U.S., Competition Concerns, 95 Tax Notes Int'l 444 (Jul. 29, 2019).
[9] *See* Stephanie Soong Johnston, U.K. Shadow Chancellor Warns Against Dropping Digital Tax, 97 Tax Notes Int'l, 1032 (March 2, 2020).
[10] *See* Stephanie Soong Johnston & Teri Sprackland, French Lawmakers Reach Compromise to Advance DST, 95 Tax Notes Int'l 64 (Jul. 1, 2019).
[11] *See* Johnston *supra* note (9), at 1032.
[12] *See* Andrew Goodall, U.K. Budget Confirms DST Plans, Cuts Entrepreneurs' Relief, 97 Tax Notes Int'l 1212 (Mar. 16, 2020).
[13] *See* Stephanie Soong Johnston, U.K. to Mull Digital Taxation, As Part of U.S. Trade Policy, 97 Tax Notes Int'l, 1121 (Mar. 9, 2020).
[14] *See* France Starts a Digital Tax War: Macron's levy on U.S. tech giants plays into Trump's hands, WSJ the Editorial Board, July 17, 2019.
[15] *See* Stephanie Soong Johnston, U.S. and France Strike Compromise Over Digital Services Tax, 164 Tax Notes Federal 1629 (Sept. 2, 2019).

end of 2020 and that the US would urgently shelve its retaliatory tariffs against France (the US and France plan to continue discussions aimed at reaching a new solution while cooperating in ongoing OECD discussions on creating new international rules concerning digital taxation[16]). However, on October 18, 2020, France announced that it would revive the suspended DST in December of the same year.[17] This was because the anticipated consensus in the OECD had been put off until mid-2021. After the US presidential election, how things will turn out regarding France is once again touch-and-go.

As of March 2020, the many countries that have decided to introduce a DST have been told to suspend collection of the tax until a decision came from the OECD.[18] In the meantime, reaching a consensus in the OECD is surely the best strategy. However, as described above, it will not be easy to reach a consensus between all countries participating in the inclusive framework.

Even if they are only interim measures, there are a few problems with DSTs. First, one could ask what the tax relates to. At least in a pro forma sense, they have taken the form of a sales tax, rather than a direct tax on profits. Thus, even if this results in international double taxation, it may not be necessary to give relief under treaties. Then, if all countries introduced DSTs unanimously, double taxation would arise not just between corporate tax and DST but also between different DSTs; even in this situation, given that DSTs are unilateral measures, the double taxation might not be lifted. Unilateral taxation without consensus opens the door to an absence of steps for resolving disputes with substantial double taxation (or multiple taxation), imposing a serious burden on the taxpayer[19] (furthermore, DSTs may be in violation of the World Trade Organization[20]).

As the back-and-forth between the US and French governments shows, the DSTs introduced by each country (or planned for introduction) are also to a great extent a political strategy. If France's DST is an arbitrary system that only targets US companies, this will surely hinder tax neutrality.

However, theoretically speaking, as a general system, the DST should not be so easily dismissed. Even if DSTs are not neutral, and even if the current international taxation rules are a neutral system (with powerful authority to control the market), this neutral tax system permits giant IT multinational corporations to transfer their profits to low-taxation countries and, at the very least, has not produced satisfactory taxation outcomes for the market jurisdictions of these corporations.[21] There is scope in DSTs for the possibility of making inroads into ending the current situation.[22] On the basis of this premise, the goal of this paper is to

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[16] *Nihon Keizai Shimbun* for Jan. 24, 2020, morning edition, p. 9. Currently Criteo seems to be exempt from DST. *See* Robert Goulder, Tesco and Vodafone: Implications for the Future of DSTs, 97 Tax Notes Int'l 1224 (Mar. 16. 2020).

[17] *Nihon Keizai Shimbun* for Oct. 20, 2020, evening edition, p. 8.

[18] *See* Rick Minor, EU Action Agenda Targets Tax Fraud and Simplification, 97 Tax Notes Int'l 1385 (Mar. 30. 2020).

[19] *See* Tetsuya Watanabe, Digitalization of the Economy and Taxation, *Zeiken*, Vol. 207, p. 23 (2019).

[20] *See* Annagabriella Colon, Tariffs May Not Be the Best Way to Counter French DST, Experts Say, 95 Tax Notes Int'l 362 (July 22, 2019).

[21] In other words, substantial neutrality has not been achieved. *See* Daniel Shaviro, Digital Services Taxes and the Broader Shift From Determining the Source of Income to Taxing Location-Specific Rents, NYU Law and Economics Research Paper No. 19-36 (Jan. 30, 2020), at 48.

explore whether there are rationales for imposing a DST, and what that rationales would be?

With consensus yet to be reached in the OECD, many countries have decided to withdraw their DSTs. However, even if a consensus is reached, until the OECD plan has been put into implementation, there will be many amendments that must be made to national laws, and it is to be expected that this will at the very least take a number of years. In the meantime, essential questions will need to be answered, such as: Should the DSTs that have already been introduced continue to operate? Should they be repealed at the consensus stage? Should the taxes already collected be refunded?

II. Where the problem is/location of the problem

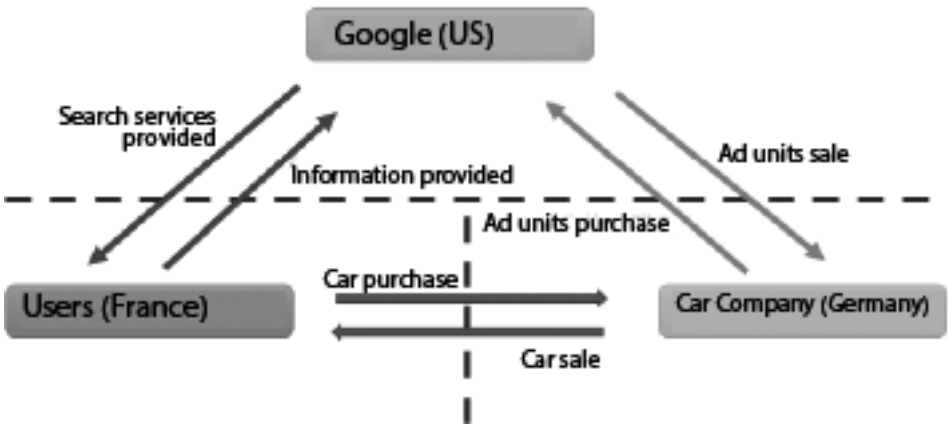
The reason countries have pushed DSTs as a temporary or unilateral measure may be that digital platform corporations such as Google and Facebook do not pay enough corporate tax in the countries where these corporations' users are located (the user country). Moreover, the existing rules on international taxation make it difficult to impose corporate tax on platform corporations in the user country.

To consider this issue, take the example of Google, a US company, receiving advertising profits by selling advertising slots (advertisement spaces) targeting users in France to an automobile company in Germany (see Figure 1). For France, it is as though Google does not exist as a Permanent Establishment (PE) (even if it did exist, the advertising profits would not attribute to that PE).

The users in France would have searched with a Google product, such as an app, for

Figure 1

US company Google receives advertising profits by selling advertising slots targeting users in France to a German car company



[22] *See* Shaviro, *supra* note at (21), at 46 and 54.

free. Since Google's share of search services is overwhelming, Google would have obtained a huge amount of information from the searches of users in France. Analyzing and processing this information would allow Google to distribute effective advertisements to users who might buy German cars (targeted advertising). This is how Google is able to sell advertising slots to German companies trying to sell cars in France.

The three parties—the German car company, the user in France, and Google—can each be considered as a possible target for the taxation of earnings in France. First, there is taxation of the German car company, but since this is usually thought of as the sale of manufactured goods through a subsidiary or a French branch store (the PE), this can be taxed in France as sales profit. The German car company has only sold the product in France, so existing taxation rules can handle this adequately.

Next, there is taxation of the user. The user seems to have used the search service for free but can actually be thought of as having used the search in exchange for their personal information. Strictly speaking, one could say that the user sells their personal information and buys the search service (a barter transaction), but there is little value in the personal information itself that has been obtained through this search ("raw" or "unprocessed" personal information). Its value increases rapidly through so-called big data, the collection, analysis, and processing of large amounts of personal information. It is not the user who does this, but the platform corporation. In other words, even if the user could be taxed, it is highly likely that this would be limited to only a very small amount of money.

Moreover, users who use video streaming services such as YouTube are shown ads when they use the service. This is similar to seeing advertisements added to commercial broadcasting on television. Just because they are watching the television for free, it does not follow that the viewer may be taxed (at least, this has not been the case thus far). Seen in a similar way, it is not realistic under the circumstances to tax users who watch YouTube.

Finally, there is the taxation of Google, which is surely the issue to be addressed here. Google's income from advertising profits is based on the personal information of users in France. Despite this, the current taxation rules do not allow France to tax these earnings. This is because France is neither the source country nor residence country of the taxpayer.[23]

III. Location-Specific Rent

The DSTs introduced by each country (or being considered for introduction) are taxes that are levied on the premise that platform corporations such as Google earn profits on a global scale, while their burden of corporate tax is extremely low compared to traditional corporations.

However, this brings up questions such as why the taxation of platform corporations' income from sales is standing in for corporate tax. Even if this can be overcome, the question remains: why would it be possible for platform corporations to be taxed by the countries

[23] Also, France cannot impose VAT on sales of advertising slots.

where their users are located (user country)? (What is the basis for the right of taxation?)

Professor Wei Cui and colleagues have penned a detailed discussion of this issue based on the user country's right of taxation, having analyzed DSTs from the point of view of resource rent taxes (resource royalties) paid to governments for the mining of natural resources[24] [25] [26]. There are many points of difference between mining for natural resources and the internet platform system's provision of services to users, but both activities can be thought of as earning a Location-Specific Rent (LSR) in the sense of excess profits that are location-specific. Based on Cui's opinion and Daniel Shaviro[27] and Martin Sullivan's[28] recent analysis of it, I will consider the rationale behind a DST.

I should state in advance that in places where platform corporations have no physical presence, and where users do not pay anything to the corporation (user countries), the rationale for taxation under a DST is essentially related to what kind of LSR has been arisen in the sense of excess profits that are specific to the location, and the reason why LSR might have been arisen.

IV. LSR in natural resources

There may be cases where natural resources produce rent in the form of excess profits. For example, suppose that it costs $100, including normal returns, to mine natural resources that exist in Country N, but that after mining they can be sold for $500. In such a case, $400 in excess profits, or rent, has been arisen. Even if this $400 is taxed, since the normal returns have not been taxed, this does not put a strain on economic activities, and in this sense the taxation could be described as ideal. Thus, in this case, Country N, where the natural resources are located, is generally thought to be entitled to preferentially tax the $400 in rent.

Although stakeholders such as mining companies, consultants, and clients are essential for the mining industry, these stakeholders may come from all over the world and are not specific to the location. In this sense, what is specific to the location is the mine, which is a natural resource, and consequently the $400 rent that originates in the mine is non-transferrable and specific to the location; that is, it can be referred to as LSR.

Furthermore, Country N's taxation of this rent has location neutrality. For example, if Mining Company X1 from Country X mines in Country N, and Country X taxes the $400 rent in the company's country of residence, Company X1 may have an incentive to relocate to a country with a lower tax rate than Country X. From the point of view of the state, this means a competitive reduction in taxes. Conversely, if only Country N has the right to tax

[24] *See* Wei Cui, The Digital Services Tax: A Conceptual Defense, Tax Law Review, Forthcoming. SSRN paper (Apr. 22, 2019). https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3273641.

[25] *See* Wei Cui and Nigar Hashimzade, Digital Services Tax as a Tax on Location-Specific Rent, CESifo Working Paper Series No. 7737. SSRN paper (Jan. 23, 2019). https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3321393.

[26] *See* Wei Cui, The Superiority of the Digital Services Tax over Significant Digital Presence Proposals, National Tax Journal 72(4), 839 (Nov. 2019). https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3427313.

[27] Daniel Shaviro, *supra* note (21).

[28] *See* Martin Sullivan, Economic Analysis: A Simple Explanation of the Sophisticated Case for Digital Taxes, 97 Tax Notes Int'l 473 (Feb. 3, 2020).

that rent, X1 has nothing to gain from relocating to a country with a low tax rate, resulting in a tax system that is neutral regarding the location of business operations.

V. Digital platform businesses and LSR

The question of whether digital platform corporations earned LSR in the same way that the mining of natural resources does is examined below.

V-1. Network effects

The development of IT-related platform companies requires that an increasing proportion of people in the market use those companies' products, such as their apps. In the IT market, this is because of the existence of the network effect.

The network effect has been described as arising from the fact that users' convenience relies upon the scale of the network that connects users together. The network effect itself is not a particularly new idea; an older example would be telephone networks. If only one person in the world owned a telephone, the device would have no purpose (because they could not talk to anyone). However, from the second device onward, the more telephones are added to the network, the more useful they are to each user (because the number of people they can talk to grows). This is an example of a direct network effect.

V-1. Indirect network effects

IT platform companies have networks with two or more sides. An easily understood example is the famous car-sharing app Uber (see Figure 2). If many drivers (hosts) use Uber, then the customers (guests) that use the same app can easily find a car without much of a waiting time. The drivers also are better able to find customers by using an app themselves that is used by many customers.

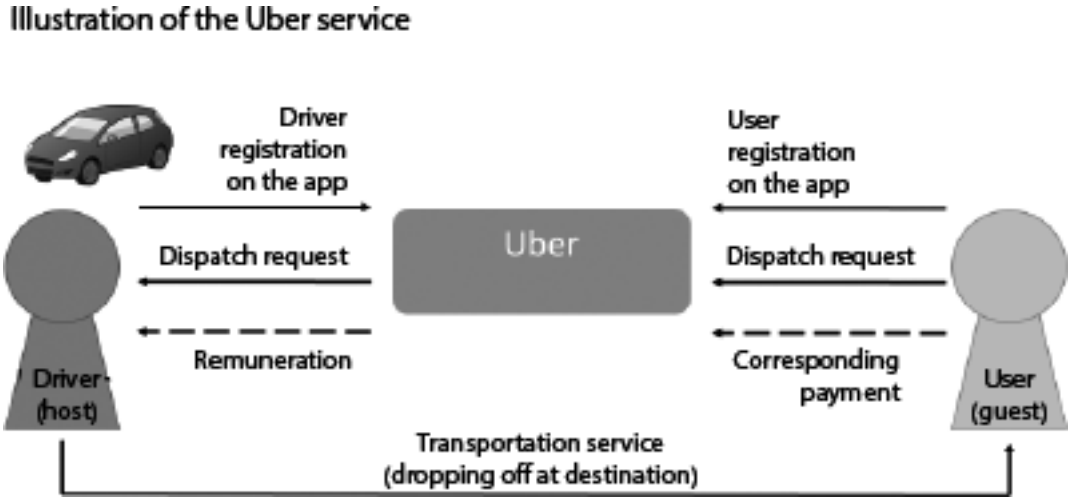
This is thus a two-sided network, and growth in the number of users on each side is mutually connected.[29] This effect may also be referred to as an indirect network effect.[30]

For this very reason, platform corporations make large initial investments in growing the users of products such as their own apps in the market. Platform corporations that succeed in doing so grow more rapidly and in a much shorter space of time than traditional companies do, and it is not uncommon for them to almost monopolize the market. The exemplars of this include Google and Amazon. These corporations initially invested an enormous amount, established market superiority over their competitors, and were able to grow into giant multinational IT corporations.[31]

Rent arises because of superiority in the market. Even if that rent is taxed, although this

[29] *See* Andrew McAfee & Eric Brynjolfsson, Machine, Platform, Crowd: Harnessing Our Digital Future, 214 (W.W. Norton & Company Ltd., 2017).
[30] *See* Cui, *supra* note (24), at 11; Cui, *supra* note (26), at 14.

Figure 2



will not cause strain in domestic business dealings, when it comes to international business dealings, if this rent is not location-specific, it may cause strain in the choice of location.

Indirect network effects also arise in Google's projects. This can be explained using the earlier example (the example of US company Google obtaining advertising profits by selling advertising slots targeting French users to a German car company).

If users increase in France, information obtained through search services will also increase. That is, Google's user growth in France will increase the value of Google's advertising slots to the German company that wishes to sell cars in France. For Google, acquiring users in France affects the advertising profits that it can obtain from a German company. Thus, there is an indirect network effect in Google's two-sided business.

There is nothing particularly new about the occurrence of this kind of indirect network effect either. In the newspaper business, for example, the more readers a newspaper has, the easier it will be to obtain advertising profits. In other words, if readers increase, the newspaper company has an advantage in the advertising market. In this case, too, an indirect network effect emerges whereby the growth of users in one market (the readers' market for newspapers) increases value in another market (the advertising market).

V-3. Hidden profits and value creation

Central to the example of indirect network effects shown in the newspaper business is the fact that the two prices of subscription charge and advertising rates influence one another. Both are a source of income for the newspaper, but maximizing total profits requires

[31] *See* Tetsuya Watanabe, Platform Companies Involved in the Sharing Economy and Taxation, *Zeikeitsushin*, Vol. 74-2, p. 7 (2019).

thinking about how best to set each price.

Since the two markets—subscription charges and advertising rates—influence each other, deciding on a price is not simple, but it allows for different price settings compared to businesses that operate in only one market. For example, the number of readers can be increased by reducing the subscription charge (even making it free, depending on the situation), and as a result, the advertising rates can also be set higher.

This can also explain Google's provision of a search service for free. Providing a search service for free to users in France may, as a result of the increasing number of users and Google's acquisition of information about more users in France, allow Google to sell advertising slots at a higher price to German companies that want to sell cars in France.

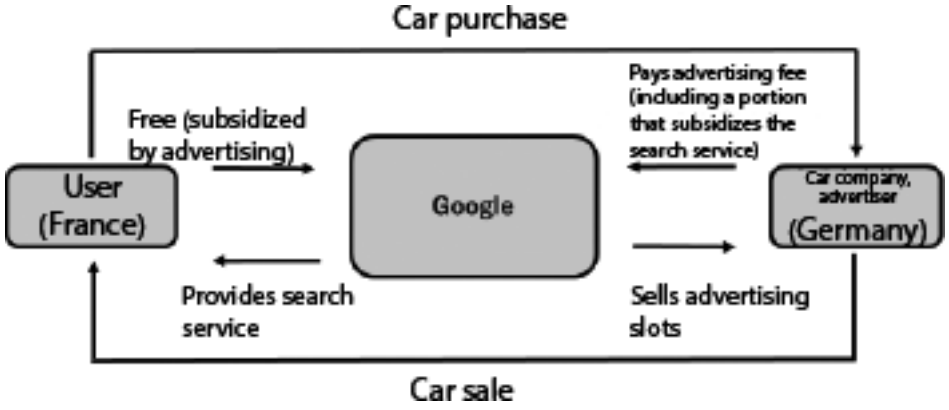
In a two-sided business, it is possible to sell or provide for free in one market (the French market) because the profits is replaced (subsidized) by profits from selling or providing products such as services in another market (the German market). This is a result of considering how to maximize total profits and can be understood in terms of Google's rational economic judgment as a corporation.

Therefore, on the face of it, no profits was generated through the provision of search services in France, but in practice it allowed the advertising rates to increase, and this profits was collected in Germany. In other words, you could say that profits from the advertising service is hidden; it exists in practice, but you cannot see it (see Figure 3).

The German car company buys advertising slots from Google in order to increase its sales in France. Naturally, if users in France did not use Google, there would be no expected increase in sales in France. In that sense, the participation of users in France increases Google's earning power.

Having understood this, it is not inconceivable that the profits from advertising targeted at France have been obtained from users in France; this would mean that users in France

Figure 3[32]



[32] Based on Cui, *supra* note (26), at 27.

have brought about value for Google (Cui's claim is that this is not inconceivable[33]). In other words, the profit Google makes from advertisements targeted at France are based on value created in France.

V-4. Two-sided business run by large-scale digital platform corporations

When thinking about two-sided businesses run by giant digital platform corporations such as Google, attention must be paid to the following two points. First, because of enormous prior investments in technology, the marginal cost of collecting information on users in one market (France) is close to zero, and the marginal cost of providing relevant information to buyers of advertising in another market (Germany) is also close to zero. If the marginal cost is zero, the profits from sales of advertising slots is identical to rent.

In this case, taxing sales is also taxing profits.[34] Therefore, as long as Google can charge a discretionary price higher than zero, it can sell advertisements targeted at France to anybody, regardless of the market, based on a structure whereby the marginal cost is close to zero.[35]

Second, advertisements targeted at French users are of no use (utility value) other than to French users. If Google did not sell advertising slots to the German car company, they would surely sell them to Italian clothes companies or British car companies that want to increase their sales in France.

As described above, Google's superiority in the market earns rent due to the sales of advertising slots. This rent comes from the information provided by French users (i.e., it is LSR). If the rent is thus tied intrinsically and specifically to France, then just as in the case discussed regarding resource mining, that would lead to a rationale for the taxation of this rent, on the grounds that the value created should be assigned to France.[36]

Much as in the case of mining, if the right of taxation is assigned to the jurisdiction endowed with immobile location-specific factors, then even if the rent is taxed, this would not create incentives for the related parties to relocate (location choice would be neutral).[37]

VI. Areas other than resource mining and digital (e.g., pharmaceutical companies)

The legality of taxing digital services as described above can be justified through the special taxes in other industries. LSR plays a decisive role in these cases (LSR is not necessarily associated only with two-sided businesses). The essential matters here regarding LSR are market competitiveness brought about by the rent (for example, the competitiveness brought about by large-scale prior investments in technology), a marginal cost of almost

[33] *See* Cui, *supra* note (26), at 16.
[34] *See* Sullivan, *supra* note (28), at 475. *See also* Cui, *supra* note (24), at 25.
[35] *See* Cui and Hashimzade, *supra* note (25), at 4.
[36] *See* Sullivan, *supra* note (28), at 475.
[37] *Id.*, at 476.

zero, and noncompetitive use.[38]

These could also be features of the pharmaceutical industry. The development of new medicines comes at a huge cost, whereas the marginal cost of additional manufacturing is close to zero and the geographical markets are separate from one another (i.e., consumption of a medicine in one location does not influence consumption in another location). If part of the rent obtained by pharmaceutical companies was location-specific (i.e., LSR), then one might expect it to be taxed in the same way as a DST. However, in practice this is not the case.

One reason for this may be that governments around the world control the prices of new medicines (rather than imposing taxes), and as a result, the economic rent created through the investments of pharmaceutical companies has been shared among the patients who are the consumers of these medicines (who would shoulder the burden if there were no price controls). To put it simply, using price controls instead of taxes is a way of making pharmaceutical companies give consumers the profits from rent generated by new medicines.

Cui takes Grinberg's view[39] that patients in clinical experiments (clinical trials) represent an important form of "user participation" that creates value for pharmaceutical companies and asks whether the profits of pharmaceutical companies should be taxed in the countries where the trials were conducted.[40] Clearly, the government is already sharing that LSR publicly by controlling drug prices, using political measures for public supply of certain medical and pharmaceutical products, and imposing import duties.[41] The rationale for understanding LSR is that governments will not necessarily always use corporate tax; there are various political measures available. If they do so, however, they could appeal to similar justifications as the deployment of these other policy instruments.[42]

The DST has been attacked as an inefficient turnover tax and an arbitrary proxy for inadequate corporate tax. However, in the US in particular, DST has been criticized as foreign governments obtaining tax revenue by taking advantage of American companies that make huge profits. Cui's opinion, which suggests that the DST is a tax on profits, can form the basis of a counterargument against the first two criticisms (the inefficient turnover tax and the arbitrary proxy for corporate tax).

However, this cannot overcome the political need for US policy makers to protect their own country, so the US government is predicted to deny approval of a DST.[43] However, there may come a time in the future when the US may also want to tax rent earned in the domestic market by foreign multinational corporations, because there is no guarantee that the era in which American companies are the major digital platform corporations will contin-

[38] *Id.*
[39] *See* Itai Grinberg, User Participation in Value Creation, 2018 British Tax Review 407 (2018).
[40] *See* Cui, *supra* note (26), at 19.
[41] Here Cui cited the following Bankman et al. *See* Joseph Bankman, Mitchell Kane, and Alan Sykes, Collecting the Rent: The Global Battle to Capture MNE Profits. Forthcoming in Tax Law Review. SSRN paper (Nov. 16, 2018). https://ssrn.com/abstract=3273112.
[42] *See* Cui, *supra* note (26), at 19.
[43] *See* Sullivan, *supra* note (28), at 476.

ue.[44]

Furthermore, UK and France's DSTs, which apply the condition that proceeds be above a certain scale, would be unlikely to apply to European corporations. However, setting aside cases where there is no logical explanation for the requirement that proceeds be above a certain amount, other than to blatantly take shots at American corporations, if it is conceivable that LSR is generated by larger corporations with controlling power over the market due to their extremely large scale, then there would be scope to justify setting a threshold.[45]

This consideration of LSR here only requires that it be possible for LSR to apply to not just Google, Amazon, Facebook, and Apple and pharmaceutical companies but also to streaming services such as Netflix and Spotify and brick and mortar businesses such as Starbucks (i.e., that these companies also generate LSR).

VII. Would DST be paid by consumers in the user country?

There is a point of view regarding DST that, in the end, it would be consumers in the user country who bear the burden of this tax.[46] Taxes on alcohol, tobacco, and gasoline eventually become the consumer's burden, because prices are raised, and it is claimed that the same would happen with a DST.

Taking the example of Google, although the DST would be paid to the French government in connection with advertising profits related to French users, were that to happen, Google would sell advertising slots to the German car company at a higher price. For this reason, the German car company would sell its cars at a higher price to French consumers. In other words, countries that impose a DST would be effectively building an elaborate Rube Goldberg machine designed to indirectly impose on citizens of their own country a regressive tax on goods.

It has also been pointed out that the "hidden profits" taxed by DST-like policies are not those of multinational "monopolies" rather, these taxes hit the everyday transactions of local consumers (similarly, if the US followed such a gross receipts model of taxing the alleged rents of pharmaceutical companies, then those left holding the purse would largely be households that pay a share of their health insurance premiums and government-run insurance programs funded by American taxpayers).[47]

However, whether the portion to be taxed as a DST can be so smoothly passed on is a case-by-case matter that depends on the related parties' situations. Setting aside Google, which has dominance in the market, if German car companies were to transfer the full DST amount to the price of their products, their products might not sell in France. The DST might not necessarily become a tax on the country's own citizens.

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[44] *See* Shaviro, *supra* note (21), at 12.
[45] *Id.*, at 11 and 52.
[46] *See* Sean Lowry, Digital Services Taxes Would Hit Transactions of Local Consumers, 166 Tax Notes Federal 965 (Feb. 10, 2020).
[47] *See* Lowry, *supra* note (46), at 965.

Cui recognizes that DST may increase prices paid by domestic producers and consumers but income taxes may also have such effect, and moreover that the country imposing the DST may well view such increases as a reasonable price to pay for capturing some of the rent earned by platform companies.[48]

Drawing on the example of newspapers, some research has been indicated that when newspaper subscriptions are subject to taxation, the newspaper may lower (rather than raise) the price of subscription in order to increase newspaper circulation.[49] Doing so could attract additional advertisers and increase profit on the advertising side. This would mean that consumers would not be able to say that they are paying the increased taxes.

VIII. Unilateral measures

Cui asks what the problems are with a DST as a unilateral measure. There are two main problems. The first is that if it taxes LSR, coordination is surely required on the basis of current tax treaties concerning income tax; the second is that although there are countries that introduce unilateral measures with goals other than taxing rent (such as an "equalization" tax, with a view to putting digital platform corporations and traditional companies on an equal footing), it will surely become necessary for these unilateral measures to be reconciled with the DST.[50]

With regard to the first problem, countries where LSR has been arisen (in the Google example, France) are not source countries in terms of traditional tax rules (they are also not residence countries); therefore, even if they tax these companies, they have not taken steps to eliminate double taxation, such as foreign tax credit. On this premise, one could ask, if the DST was not recognized for foreign tax credit, what exactly would be the problem?

If foreign tax credit does not apply to the DST, the default treatment in most residence countries for foreign taxes paid is to grant a deduction. Cui explains that if the DST is successfully designed as a tax on economic rent, however, a deduction of the DST from the income tax base would still leave room for an income tax to be imposed without causing distortions.[51]

In practice, standard corporate tax systems have also come to leave scope for additional taxation on unusual returns, such as those with excess profits (in addition to ordinary corporate tax). Historically, many such taxes on rent have been left out of treaty-based coordination, instead being treated as taxes covered by the treaties.

Thus, Cui argues, it is not clear why one should presume that the DST should be creditable against income taxes, instead of being deductible from taxable income. In the absence of such a presumption, however, the lack of coordination between the DST and regular cor-

[48] *See* Cui, *supra* note (24), at 3.
[49] *See* Cui, *supra* note (24), at 26; Hans Jarle Kind, Marko Koethenbuergery, and Guttorm Schjelderup, Tax Responses in Platform Industries, 62 Oxford Econ. Papers 764 (2010).
[50] *See* Cui, *supra* note (26), at 19.
[51] *See* Cui, *supra* note (26), at 20.

porate income taxation raises no special concern.[52]

The second problem is the coordination of DSTs aimed at taxing LSR with unilateral measures introduced with other aims (such as equal footing). For example, India's Equalization Levy and Italy's Levy on Digital Transactions are imposed in the advertisers' tax jurisdiction. Supposing that Facebook sold advertising slots targeted at French consumers to Italian or Indian makers, the advertising profits Facebook received might be targeted for revenue-based taxation in India or Italy in addition to the DST in France. With these countries' systems for digital services implemented as unilateral measures, those new taxes on digital services take conflicting views about where profit from such services should be attributed. Consequently, double taxation can occur.[53]

It is difficult to resolve these problems according to the treaties. Since there are limits to the elimination of double taxation in income taxes according to the treaties, it will be even more difficult to coordinate matters that are not income tax. The EU proposal in 2018 was to apportion the revenue to EU Member States according to the number of users within them, and this is of course just one of the solutions. Nevertheless, the EU European proposal was not implemented, and even if it had been, it would only have taken effect within the EU. In the example above, it may seem unlikely that India, a non-EU country, has signed a tax treaty with France, and the unilateral measures taken by each country could be mutually coordinated.

Even if the second problem is understood as a problem with the allocation of new taxation rights concerning corporate profits, coordination from each country will not be easy to obtain. Cui presents one viewpoint that, such coordination may simply be done through an acknowledgement that new taxes imposed are not in conflict with existing international obligations, much as the imposition of resource royalties, resource rent taxes, taxes on extraordinary profits, and similar taxes by different governments.[54] It seems that, the view that each country can carry out unilateral measures for taxes other than income tax, and that there is no need for coordination, such as eliminating double taxation between them, has already been accepted by the international community.

With regard to the second problem, Cui states that there is no need to coordinate double taxation because a DST may be the same as resource rent taxes and the like. On the other hand, DSTs that tax LSR can be viewed as taxes on turnover; however, since the marginal costs of the taxpayer (such as Google and Facebook) are close to zero, they can be considered identical to profit.[55] Cui may have argued in part that a DST is within the scope of income tax, at least with regard to the first problem.

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[52] *Id.*, at 21.
[53] *Id.*, at 22.
[54] *Id.*, at 23.
[55] *See supra* note (34).

IX. Conclusion

Cui's opinion is persuasive insofar as he positions DSTs as a similar measure to resource rent taxes to explain the rationale for them. However, personal information is not at all like a resource. For example, there are the following differences.

First, in order to mine resources, the company must actually go to that country (in the poorly fitting example of Google, France would be the country where the mine is located). Collecting personal information can be carried out through the internet from another country (in the example of Google, this is the US). This is a particular characteristic of internet companies. Second, with resources, their value is more or less understood at the mining stage (approximately how much they would be expected to sell for), but the value of personal information and to whom it might be sold is not so clear when it is being collected. Information first becomes commercialized after a large amount of it has been collected and it has been analyzed and processed (for that purpose, platform companies must secure victory over their competitors in the same business). Moreover, it is largely artificial intelligence that creates added value through the analysis and processing of information.

Despite the above differences, it is difficult to deny conclusively that personal information has value as a resource. Conversely, for digital platform corporations, since it is clear that personal information has value, it makes more sense to recognize that user countries have a certain right to tax it than to think that they have absolutely no right whatsoever to do so. The essential issue here is not just whether a DST, as a special tax, is the same as a resource rent tax (resource royalties), but the extent to which this can serve as a rationale for income tax.[56]

Existing theories of income tax may make it difficult to confirm the user country's taxation rights, but there is still scope to affirm it from the point of view of the allocation of new tax rights. If we consider the taxation of rent, rather than normal profit, as itself a neutral and ideal corporate tax, there is an aspect of DSTs' taxing of LSR that taxes corporate income. On this point, Cui has noted that if the momentum for international tax reform is born from a need to reallocate taxing rights, then one must acknowledge the fact that the DST addresses this need directly and explicitly.[57]

The profit that a platform corporation (Google) earns from search services is hidden, but clarifying this at the point in time that a service is provided is difficult. This is because at the stage that the information is being collected, it is not necessarily clear who exactly will buy the advertising slots sold on the basis of the personal information acquired. Accordingly, profit calculation must wait until the time that the advertisements are being sold.

The example of pharmaceutical companies is similar. The development of a new medicine will not necessarily succeed; indeed, an overwhelming number of them fail. When they succeed, the profits were not known at the clinical trial stage. Therefore, even if the country

[56] *See* Cui, *supra* note (26), at 16.
[57] *Id*., at 24.

where the patients are located had the right to tax the medicine, the profit calculation would have to wait until the new medicine is being sold. This kind of taxation seems to be based on a similar idea to the rules for "hard to value intangibles" (HTVI).

Cui's attempt to justify DSTs with LSR highlights theoretical aspects of a DST that had been the subject of criticism, and has created a stir in discussions on the topic. Going forward, attention should be paid to further appraisals of this attempt and the effects it has on each country's system.